JENSEN™
INVESTMENT MANAGEMENT

INSIGHTS
MARCH 2024

Quality Down the Cap Spectrum

In the current investment climate, the case for quality mid-caps is compelling. We believe high returns on capital, robust balance sheets and profitability are indicative of companies poised for success. Jensen's Quality Value Strategy, honed since 2010, offers investors a path to explore the potential of quality mid-caps and go beyond the realms of small- and large-cap investing.

Tyra Pratt
CFA, Portfolio Manager

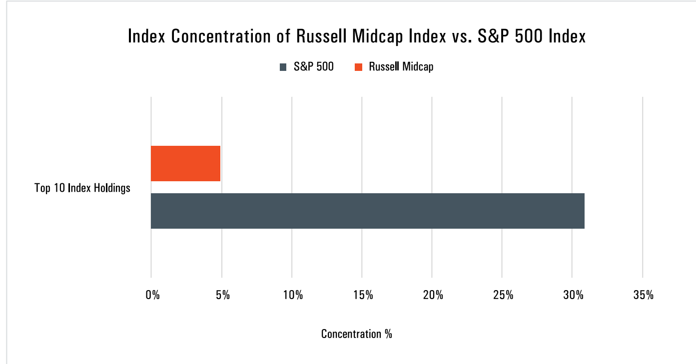
In the vast landscape of investment opportunities, mid-cap stocks are often overlooked in favor of their large-cap or small-cap counterparts. We believe that mid-cap stocks can offer a mix of characteristics from both large and small companies, potentially combining diversification benefits with an attractive risk profile and current valuation opportunities that make them worthy of financial advisors' attention.

Our research shows that mid-cap companies have historically offered the growth potential of small-caps, while striving to attain risk characteristics more often demonstrated by larger, more mature companies. We believe that relative to small-caps, mid-cap companies have often advanced past their most unpredictable growth phase, tempering volatility but still providing a runway for potential future growth. Relative to large-cap peers, mid-cap companies generally tend to garner less attention from sell-side analysts.[1] This relative lack of scrutiny leads to a greater variance in

[1] Source: Refinitiv Eikon as of 12/31/2023.

valuation estimates and can create room for active investment managers to find strong businesses at what we contend are desirable valuations.

At Jensen, we seek high-quality companies, which we define as profitable businesses with strong competitive advantages that are capable of generating returns above their costs of capital in a variety of environments. We determine an initial investible universe by focusing only on companies that have produced a return on equity (ROE) of 15% or more for at least 10 consecutive years. From there, we conduct deep and thorough research to further reveal the most compelling opportunities for us.

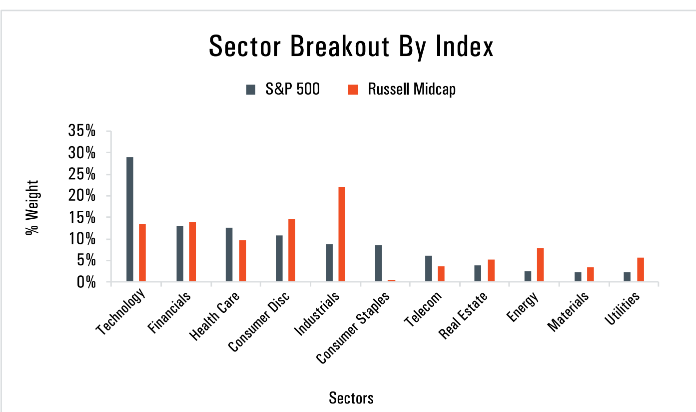


Source: Refinitiv Eikon as of 12/31/2023

Company & Sector Diversification of the Mid-Cap Indexes

We believe that mid-cap strategies can be seen as increasingly appealing to advisors seeking stock diversification as the S&P 500 Index continues to reach historically high levels of concentration. In our view, mid-cap stocks may offer long-term investors multiple diversification benefits while complementing large-cap allocations and moving away from both single-company and single-sector exposure.

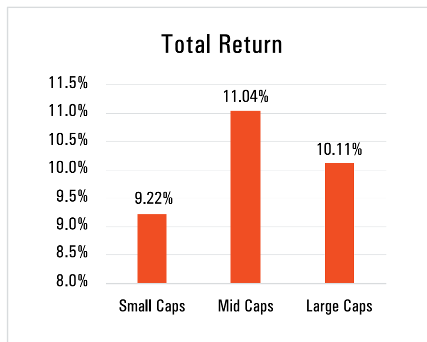
As of Dec. 31, 2023, the top 10 companies in the S&P 500 Index accounted for approximately 30.9% of the index, compared to 4.9% for the top 10 companies in the Russell Midcap Index. Because the S&P 500 is a market-cap weighted index, when these companies do well so does the index. In contrast, the Russell Midcap rebalances annually to ensure that it is not overly influenced by a small set of companies.

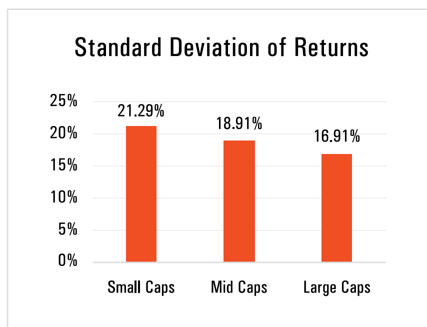


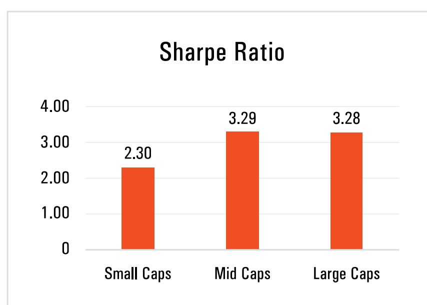
At the sector level, the Russell Midcap Index also provides less concentrated exposure. Industrials is the largest sector, making up approximately 21.6% of the index, while Technology, the largest sector in the S&P 500, accounts for approximately 29.1% of that index.

Attractive Risk-Adjusted Returns

While acknowledging that past performance is not indicative of future returns, the case for mid-caps can also be made when examining historical performance. As demonstrated by the charts below, mid-caps have historically produced a higher average annual return and lower volatility relative to other asset classes.

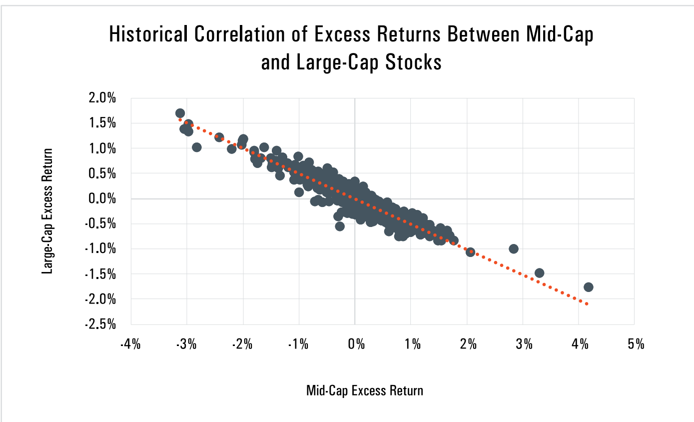






Source: Refinitiv Eikon, period from 11/1/1991 to 12/31/2023. Total return, standard deviation of returns and Sharpe ratios are annualized. Small-caps = Russell 2000, mid-caps = Russell Midcap, large-caps = Russell 200. Past performance is no guarantee of future results. Indexes are unmanaged. You cannot directly invest in an index.

When combined with large-caps, mid-cap stocks may help balance the risk profile of an investor's overall portfolio. The chart below demonstrates that, over a 20-year period, the excess returns of mid-caps are inversely related to large-caps. This negative correlation between the excess returns of mid-cap and large-cap stocks may help investors reduce overall volatility and improve overall portfolio performance over time.

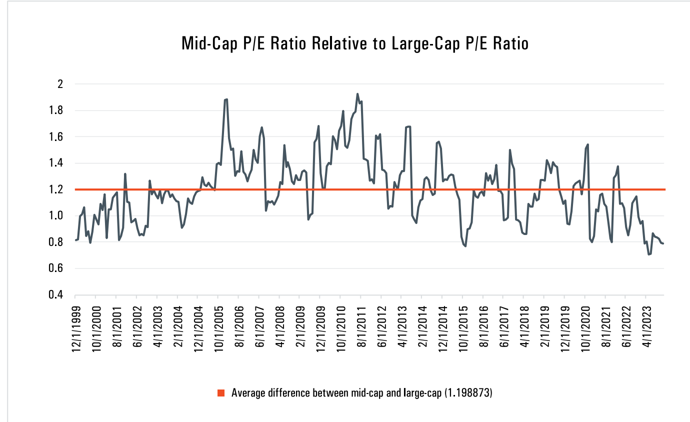


Source: Refinitiv Eikon, 12/26/2003 to 12/29/2023. Y = Russell Top 200 Index excess returns vs. Russell 3000 Index. X = Russell Midcap Index excess returns vs. Russell 3000 Index. Total negative correlation is -0.94. Past performance is no guarantee of future results. Indexes are unmanaged. You cannot directly invest in an index.

An Opportunity for Long-Term Investment

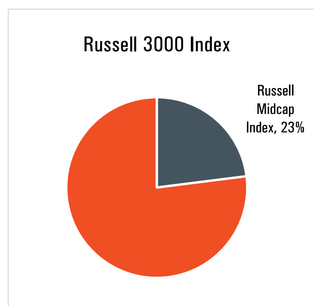
In recent years, U.S. mid-cap stocks have experienced underperformance, leading to a lower relative valuation (price to earnings ratio) compared to U.S. large-cap stocks. As shown in the chart below, valuations for mid-cap stocks are trading at a notable discount to large-caps and their respective historical averages.

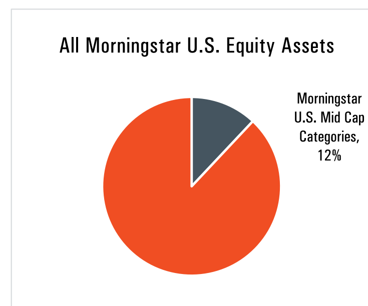
To put this valuation opportunity into perspective, mid-caps (as represented by the S&P 400) on average over the past 24 years have traded at almost a 20% premium (based on adjusted trailing 12 month P/E ratio) compared to large-caps (as represented by S&P 500). In contrast, as of Dec. 31, 2023, the adjusted trailing 12 month P/E ratio of mid-caps was approximately 20% below large-caps and approximately 34% below their historical average, indicating an attractive valuation opportunity.[2]



Source: Refinitiv Eikon, as of 12/31/2023. This chart compares the P/E ratio of the S&P 500 Index (large-cap) vs. S&P 400 Index (mid-cap). Orange line = avg. difference between mid-cap and large-cap (1.20). Past performance is no guarantee of future results. Indexes are unmanaged. You cannot directly invest in an index.

Notably, this recent underperformance has been also accompanied by an underallocation of assets to U.S. mid-caps. In our view, the combination of these factors could present an enticing opportunity for long-term investors. Mid-cap stocks make up 23% of the Russell 3000 Index, but only 12% of U.S. equity assets are invested in the mid-cap category.[3]





Source: Morningstar as of 12/31/2023

A Quality Approach to Mid-Cap Investing

Jensen's quality approach to the mid-cap market is grounded in our fundamental analysis and keen focus on valuation . We seek to buy high-quality companies, with strong competitive advantages, that are trading at a discount and represent an attractive investment opportunity. When the advantages of mid-cap investing are combined with our time-tested approach to quality, investors may experience lower volatility with downside mitigation in weak markets while still capitalizing on upside potential in strong markets.

We believe that the quality mid-cap space provides unique opportunities to find businesses with strong competitive

[2] Source: Refinitiv Eikon, as of 12/31/2023. Adjusted trailing 12 month P/E ratios: S&P 500 = 43.29, S&P 400 = 34.26
[3] Source: Morningstar, as of 12/31/23

advantages in niche industries where it may not make sense for larger companies to compete.

Furthermore, while their business models tend to be more established and mature than smaller companies, quality mid-cap companies are generally less complex than large-caps, allowing them more flexibility to adapt to changing market environments.

Conclusion

The Jensen Quality Value Strategy presents what we believe is a sound opportunity to engage with the often-overlooked mid-cap sector. By focusing on quality, value and comprehensive analysis, we provide a pathway for investors to access the potential growth and stability inherent in mid-cap companies.

Our views expressed herein are subject to change and should not be construed as a recommendation or offer to buy or sell any security and are not designed or intended as a basis or determination for making any investment decision for any security. Our discussions should not be construed as an indication that an investment in a security has been or will be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of any security discussed herein.

Generally, small- and mid-capitalization companies, and less-seasoned companies, have more potential growth than large-capitalization companies. They also often involve greater risk than large-capitalization companies. Small- and mid-cap companies may not have the management experience, financial resources, product diversification and competitive strengths of large-cap companies. Therefore, their securities tend to be more volatile than the securities of larger, more established companies, making them less liquid than other securities.

Past performance is no guarantee of future results. *The information contained herein represents management's current expectation of how the Jensen Quality Value Strategy will continue to be operated in the near term; however, management's plans and policies in this respect may change in the future. In particular, (i) policies and approaches to portfolio monitoring, risk management, and asset allocation may change in the future without notice and (ii) economic, market and other conditions could cause the strategy and accounts invested in the strategy to deviate from stated investment objectives, guidelines, and conclusions stated herein.*

Certain information contained in this material represents or is based upon forward-looking statements, which can be identified by the use of terminology such as "may," "will," "should," "expect," "anticipate," "target," "project," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance of a client account may differ materially from those reflected or contemplated in such forward-looking statements. This information is current as of the date of this material and is subject to change at any time, based on market and other conditions.

P/E Ratio: The price-to-earnings ratio is the relationship between a company's stock price and its earnings per share.

Russell 3000 Index: An index that measures the performance of 3,000 large-cap, mid-cap and small-cap entities. The index is designed to represent approximately 98% of investable U.S. equities by market capitalization.

Russell Midcap Index: An unmanaged index which measures the performance of the 800 smallest companies in the Russell 1000 Index.

Russell Top 200 Index: An index that measures the performance of the largest 200 companies in the Russell 3000 Index.

S&P 500 Index: A market value-weighted index consisting of 500 stocks chosen for market size, liquidity and industry group representation. The index is unmanaged, and one cannot invest directly in the index.

Sharpe Ratio: A risk-adjusted measure that measures reward per unit of risk. The higher the Sharpe ratio, the better. The numerator is the difference between the index's annualized return and the annualized return of the risk-free instrument (T-Bills).

Standard Deviation (Std Dev): This statistical measurement of dispersion about an average, depicts how widely a strategy's returns varied over a certain period of time. Investors use the standard deviation of historical performance to try to predict the range of returns that are most likely for a given strategy. When a fund has a high standard deviation, the predicted range is wide, implying greater volatility.

Jensen Investment Management, Inc., is an investment adviser registered under the Investment Advisers Act of 1940. Registration with the SEC does not imply any level of skill or training. Although taken from reliable sources, Jensen cannot guarantee the accuracy of the information received from third parties. Indexes are unmanaged. You cannot directly invest in an index.

JENSEN INVESTMENT MANAGEMENT
5500 Meadows Road, Suite 200
Lake Oswego, OR 97035
800.221.4384